December 14, 2020

Organisation for Economic Cooperation and Development
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Re: Comment Letter the Tax Challenges Arising from Digitalisation—Report on Pillar Two Blueprint

The National Foreign Trade Council (the "NFTC") is pleased to provide written comments on the "Tax Challenges Arising from Digitlisation—Report on Pillar Two Blueprint" ("Pillar Two Blueprint" published October 12, 2020.

The NFTC, organized in 1914, is an association of some 200 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the OECD and the Inclusive Framework in establishing and maintaining international tax and transfer pricing norms that provide certainty to enterprises conducting cross-border operations. A list of the companies comprising the NFTC's Board of Directors is attached as an Appendix.

The NFTC appreciates the opportunity to comment on the proposals for further work set out by the Pillar Two Blueprint and being discussed by the Inclusive Framework. Given the enormity of the challenge undertaken by the Inclusive Framework – providing a consensus-based long-term solution to the tax challenges arising from the digitalization of the economy by mid-2021 – the NFTC believes that it is critically important to offer a broad range of stakeholders' opportunities for input into the process.

The NFTC believes that for international tax rules to be stable and sustainable for the long-term, they must be underpinned by sound tax principles. The stated aim of the Pillar Two Blueprint is to address the remaining BEPS issues and to provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation. A global minimum level of tax was never part of the BEPS initiative nor was it included in the final BEPS Action Plan Report. The foundation on which the Pillar Two Blueprint is built is not clear. As the NFTC pointed out in our comments on the Pillar One Blueprint, the OECD Economic Impact Assessment used data that does not take into consideration either the fully implemented Base Erosion and Profit Shifting (BEPS) action items nor does it take into consideration any data following the U.S.

implementation of the Tax Cuts and Jobs Act. The Economic Impact Assessment found that the impact of Pillar Two would fall largely on MNEs engaging in profit shifting. This data excludes the impact of the U.S. Tax Cuts and Jobs Act the effect of which was to levy a tax on the accumulated foreign earnings of MNEs and to ensure taxation of all income on a current basis. The possibility to have untaxed current income has been significantly reduced, at least for U.S. based MNEs. The Economic Impact Assessment should be updated using current data so that the effects of BEPS and U.S. tax reform can be fully evaluated before the Pillar Two rules are implemented.

There is no discussion of the minimum effective tax rate in the Pillar Two Blueprint. We see the tax rate as fundamental to the discussion and how the GloBE and Subject to Tax Rule would be implemented.

This letter provides more specific comments and responds to the specific issues raised by the Pillar Two Blueprint.

GLoBE and GILTI Proposal

The GLoBE proposal sets out to address the perceived BEPS challenges through the development of two inter-related rules that would be implemented by a change to domestic law, an Income Inclusion Rule and an Undertaxed Payment Rule.

In December 2017 the United States adopted the so-called Tax Cut and Jobs Act (Pub. L. No. 115-97) ("tax reform"). Consequently, as part of that tax reform proposal, the U.S. adopted a Global Intangible Low-Tax Income (GILTI) provision that has the effect of being a minimum tax on U.S. companies to prevent companies from moving operations out of the U.S. to lower-tax jurisdictions. The GILTI provision and its interpretation by the U.S. Treasury indicate that the intention was to only tax income that fell below a certain tax rate of 13.125 percent to be sure to provide a minimum tax on companies operating in countries with a corporate tax rate lower than that. However, because of the interaction of the GILTI calculation with other changes put in place under U.S. tax reform, the actual amount that U.S. based MNEs could expect to pay as a minimum tax far exceeds the original 13.125 percent (putting aside the GILTI high-tax regulations).

The GLoBE Income Inclusion Rule is designed to operate as a minimum tax that ensures that the income of an MNE group is subject to tax at a minimum rate thereby reducing the incentive to allocate profits for tax reasons to low-taxed jurisdictions. This is similar to the reasoning the U.S. Congress used when it adopted the GILTI regime.

The Pillar Two Blueprint suggests that GILTI may be considered compliant under the Income Inclusion Rule. The NFTC strongly supports GILTI being considered a compliant regime under the Income Inclusion Rule. However, this may mean that U.S. MNEs would be subject to the Undertaxed Payment Rule and the Subject to Tax Rule. The NFTC believes that it would be appropriate to treat GILTI as a compliant regime for the purposes of both the GLoBE rules and the Subject to Tax Rule. The Undertaxed Payment Rule is a backstop rule to the Income Inclusion Rule. It should therefore be clearly stipulated that, if GILTI is accepted as qualifying as a compliant regime for the Income Inclusion Rule for purposes of the GloBE rules, other jurisdictions would not impose the Undertaxed Payment Rule on earnings of U.S. headquartered companies subject to GILTI (which includes not applying the UTPR to payments to the UPE jurisdiction). There should be no need for a new set of rules with significant compliance obligations to apply to U.S. MNEs who are already subject to GILTI. Based on the OECD Secretariat's own observation that GILTI is a more onerous provision and raises more revenue than the GLoBE, a comprehensive exception for GILTI taxpayers that excludes U.S. headquartered multinationals from the entire GLoBE regime should be consistent within the Pillar Two Blueprint objectives.

Assuming it is determined that GILTI is only a compliant Income Inclusion Rule with no broader exception from Pillar Two, there needs to be clarity around how GILTI would coexist with Pillar Two. What would cause GILTI to cease to be a compliant regime? Would minor amendments to the GILTI regime invalidate the exemption? Are there certain features of GILTI that must be retained in order to maintain the exemption? In any event changes that increase the GILTI tax burden on U.S. MNEs should not impact GILTI's status aa a compliant Income Inclusion Rule and for a broader exception from the entirety of Pillar Two.

Depending on the way in which GILTI is considered compliant with Pillar Two as an exception to the GloBE regime, there should not be much coordination necessary between the GLoBE and the GILTI rules. The timing of when U.S. tax returns are due and the due date of Pillar Two taxes should be considered especially given the fact that GILTI foreign tax credits are determined on a current year basis. If Pillar Two taxes aren't determined until after the MNEs U.S. tax return is filed, there may be foreign tax redetermination rules issues to address.

Calculating the ETR under the GLoBE Rules

If GILTI is not recognized as a qualifying Income Inclusion Rule, jurisdictional blending as part of the Income Inclusion Rule calculation should be replaced with global blending (similar to the approach adopted under GILTI) for simplification and uniformity. We would recommend global blending as a simplification for companies from countries who cannot use GILTI. It would not be practical or administrable to implement blending on anything other than on a global basis at the level of the jurisdiction of the parent company. Legal entity accounts based on the GAAP of the parent, and with transactions recognized at arm's length, are not readily available at all MNEs, and preparing such accounts is overly burdensome. Streamlined compliance and simplified administration would be significant benefits to adopting a global blending approach. The NFTC does not support jurisdictional blending which would impose significant complexity into the regime and would create substantial compliance difficulties for taxpayers.

The Pillar Two Blueprint requests comments on the treatment of dividends and gains from the disposition of stock in a corporation and how accelerated depreciation is to be treated. If the purpose of the guidance is to exclude the income from investments accounted for under the equity method of accounting, then the thresholds and methodology should be consistent with the applicable financial accounting rules for application of the equity method of accounting under U.S. GAAP which is used by U.S. MNEs.

NFTC supports the OECD's suggested adjustments to the GLoBE tax base and ETR calculations to consider the timing impacts associated with accelerated depreciation. NFTC recommends executing the adjustment for accelerated depreciation by adjusting for actual local tax depreciation.

NFTC also believes "taxes paid" for purposes of calculating the GLoBE ETR should include the utilization of any foreign tax credits (current year or carryforward) on US multinationals' federal income tax return.

Many jurisdictions have prolonged due dates for tax returns or statutory financials for a subsidiary included in a consolidated financial statement. Each jurisdiction has different rules for depreciation reportable on its local statutory financials verse tax returns. However, taxes under Pillar One and Pillar Two may be due sooner than local statutory financials and tax returns are due. Some NFTC members believe that considering all the above factors, it is easier to administer the Pillar One and Pillar Two tax rules by using depreciation per public consolidated financial statements reported to the investor community. In this situation, a U.S. MNE will use its GAAP depreciation for its U.S. and foreign subsidiaries included in its public filings. Such an approach has the added comfort that the data used has been audited by an independent auditor and it is easy for countries to verify.

Using tax depreciation (tax depreciation per local statutory tax return, bonus depreciation or ADS per U.S. GILTI rules) just adds more work without driving a cumulative difference between ETR and cash tax. Additionally, it imposes challenges on timely reports and administration.

Considering tax returns are not always audited while consolidated financial statements are always audited, it might be less administratively burdensome to use book depreciation reflected in the publicly reported financial statements.

Other NFTC members support using local tax depreciation instead of depreciation per financial statements and believe that using tax depreciation better reflects the economic realities impacting the ETR calculation. Members investing in tangible assets in high-tax jurisdictions will experience relatively low ETRs in the early years a project is placed in service solely due to the accelerated recovery of the MNE's significant investment in tangible assets in a foreign country. Once the accelerated depreciation is complete, the ETR will increase to align more closely with the high statutory tax rate. The member pays the same amount of tax overtime, but the timing of the recovery of capital allowances can cause distortions to the ETR resulting in payments of tax pursuant to Pillar Two in the early years, with no or insufficient relief for higher taxes paid in the later years. Specifically, if accelerated tax depreciation is not accounted for in the ETR calculation for Pillar Two, a member operating in a high-tax jurisdiction will be assessed top-up tax in the early years due solely to accelerated depreciation driving the ETR below the minimum rate, but then pay tax far above the Pillar Two minimum rate in the later years with no appropriate relief. The OECD should provide relief from the inappropriate advance payment of Pillar Two minimum tax solely due to accelerated depreciation by allowing an adjustment to financial statement income for local tax depreciation.

While following financial statements may be administratively convenient, it can be distortive to the extent it ignores significant timing and permanent differences between book and tax accounting. While most members are in favor of simplification, simplification should not be selected at the cost of material distortions.

Carry-forwards and Carve-outs

Carry-forwards (paragraphs 295-314) will create additional compliance issues but may be helpful. The loss carryforward rules may be helpful depending on how each jurisdictions income/loss is calculated (e.g. intragroup allocations). The Income Inclusion Rule and local tax credit rules also seem helpful in that the MNE group can use Income Inclusion Rule tax credit carryforwards from each jurisdiction to offset the group's Income Inclusion Rule tax liability from another jurisdiction. NFTC recommends allowing carryforward balances to be recognized into the future until fully utilized (i.e. indefinite carryforward). While these rules are unlikely to impact GILTI taxpayers, they may be helpful.

Pre-regime losses and local tax carryforwards would need to be calculated using the GloBE rules. No Income Inclusion credit carryforwards would arise since no Income Inclusion tax was actually paid in pre-regime years.

As with the other rules, this guidance on carve-outs is not relevant for MNEs covered by the GILTI exception. The rules seem reasonable (more generous than GILTI). A general rule for payroll allocation should be the residence of the employee which is a significant simplification than based on where activities occur. Basing the allocation on location of the work may require additional documentation (e.g time sheets) to be retained. The NFTC recommends that a specific definition of payroll costs including the most common and significant costs be included. The depreciation rules generally conform to financial reporting for simplification, so they may not need additional changes.

Simplification Options

The NFTC believes that if the effective tax rate of an MNE on a consolidated basis is above certain thresholds, the Pillar Two provisions, including both the GLoBE and the Subject to Tax Rule, should not apply, since the objective of Pillar Two is ensuring an appropriate level of taxation would have been met.

We do not believe Country-by-country reports (CbCR) should be used as a safe harbor. The CbCR report is solely a high- level risk assessment tool and the information included is prepared on this basis. Were the CbCR data to be used to comply with the Pillar Two proposal, as indicated in the Blueprint, a number of adjustments would be required to the data before it would be meaningful. Accordingly, utilizing CbCR data is unlikely to lead to reduced compliance costs or efficiencies. In addition, once the adjusted CbCR data is made available, it may be used by Tax authorities for purposes for which the report is not intended, leading to more disputes and unintended outcomes.

Undertaxed Payments Rule

The Undertaxed Payment Rule (UTPR) is a backstop rule to the Income Inclusion Rule (IIR). The NFTC believes it should therefore be clearly stipulated that if GILTI is accepted as a qualifying IIR for purposes of the GloBE rules, other jurisdictions would not impose UTPR on earnings that are included in GILTI.

The NFTC also believes that the UTPR should not be applied with respect to payments to the ultimate parent entity (UPE) of an MNE. First, the objective of Pillar Two is to ensure a minimum level of tax on foreign income earned by MNEs so as to address remaining international base erosion and profit shifting issues. The home jurisdiction of an MNE typically is the center of that MNE's economic interests and the place of ultimate management of the MNE. The home jurisdiction is more appropriately considered to be the natural location of the residual profits arising from the operation of the business, rather than a place to which profits are shifted to minimize tax.

Second, and relatedly, while all jurisdictions have a sovereign right to determine their own tax systems, that right is especially pronounced with regard to the system for taxing resident MNEs (as recognized implicitly by the design of the IIR, which permits the home jurisdiction of an MNE to impose a top-up tax on low-taxed foreign subsidiaries). The home jurisdiction of an MNE should have the right to determine the appropriate manner of taxing the domestic income of its resident UPE, balancing revenue concerns with tax incentives to encourage positive economic activity within its jurisdiction. Applying the UTPR to payments to UPEs would inappropriately encroach on the right of the home country to balance these domestic policy interests.

An obvious solution to this issue is to exempt payments to UPEs from the UTPR. To the extent there is a concern that such an exemption could facilitate profit shifting, for example in cases in which the UPE is not located in a jurisdiction that represents the center of its economic activities, targeted rules can be designed to mitigate such concerns. For example, the exemption for payments to UPEs can be limited for UPEs located in jurisdictions identified as "investment hubs" by the OECD (FDI to GDP of 125%), unless the UPE's activities in its home jurisdiction met objective substance-based criteria (e.g., relative headcount or tangible assets).

Subject to Tax Rule

The Subject to Tax Rule is applied as a priority over the GLoBE rules and it would levy a gross basis withholding tax on a wide range of payments. As such it sets a bad precedent and represents a departure from long-standing principles for profit-based taxation advanced by the OECD. The NFTC strongly disagrees that the Subject to Tax Rule should be taken as a priority over the GLoBE rules. The NFTC also believes that U.S. MNEs subject to GILTI, should be excluded from the Subject to Tax Rule. The OECD members have long worked to reduce and eliminate gross-basis withholding taxes, as has the United States, which recently has proposed rules that would preclude a tax credit for gross-basis withholding taxes that have no jurisdictional nexus to the country imposing them.[1] The OECD and the IF should not now support the imposition of withholding taxes, particularly as a priority rule under Pillar Two. The Subject to Tax Rule would require tax treaty changes to implement either through a new multilateral instrument or through bilateral tax treaty negotiations. Rather than elevating the Subject to Tax Rule to first in priority, it should simply be presented as an optional provision that bilateral tax treaty partners can decide whether to adopt and to agree to shifting taxing rights when the other Pillar Two provisions do not apply. Coordination will need to be made with similar proposals from the United Nations, such as the proposal of a new Article 12B for the U.N. model treaty.

The Subject to Tax Rule also goes against the stated objective of the Pillar Two Blueprint to address the remaining BEPS issues. The Pillar Two Blueprint is a global project and countries that are participating in good faith should not be permitted to reserve the right to take more of the residual profit through a withholding tax. Countries cannot have it both ways. A global solution cannot have a major exception or override, which is what the Subject to Tax Rule is. An unintended consequence of this rule might be to encourage more countries to impose the Subject to Tax Rule, potentially overtaking and eliminating the effectiveness of the Income Inclusion Rule and the Undertaxed Payment Rule and undercutting the Pillar One Blueprint work. It will create further compliance and administrative costs both for MNEs and tax authorities.

If the Subject to Tax Rule remains in the Pillar Two Blueprint, a more targeted list of covered payments should be identified and a clear articulation of why such payments must be captured by this rule should made. We suggest a very limited scope of payments be adopted. Additionally, the rate should be lower than the GloBE tax rate so that it correlates with the gross basis of the Subject to Tax Rule.

To the extent intragroup insurance premiums are subject to the Subject to Tax Rule withholding, the nature of insurance premiums should be distinguished from other intragroup payments. The Subject to Tax rule relating to insurance or reinsurance premium seems to disregard the economic realities in the insurance sector and would likely result in over-taxation. Critically, the inclusion of the sentence - *"If the risk does not materialise, the insurance or reinsurance premium can generate a high return,"* in the consultation misses the whole point of insurance. Insurance requires a diversification of risks so it is not appropriate to look only at a particular risk being covered; the pool of risks must be considered. If the risk does materialize, a loss far

1 Treasury and IRS proposed Foreign Tax Credit Regulations (REG-101657-20),published in the Federal Register, November 11, 2020.

exceeding the initial premium payment can arise – i.e. the risk of the adverse event occurring has been assumed by the insurer. The OECD should consider that Intragroup insurance and reinsurance premiums of MNE groups of the insurance sector should be removed from the scope of the Subject to Tax Rule.

Scope of the GloBE Rules/Excluded Entities

We applaud the exclusion from the GloBE rules of certain Ultimate Parent Entities/UPEs subject to tax neutrality regimes (see section 2.3.6., paras 96-106). In particular, paragraphs 103 – 106 describe the circumstances in which tax administrators may be confident that the owners of a UPE are subject to tax above the minimum rate on the entire income of the UPE as a result of a tax transparency regime, and accordingly in which the income of the UPE should be excluded from application of the GloBE rules. These circumstances are illustrated by reference to the S corporation rules of U.S. tax law. We believe that this approach is consistent with the objectives of Pillar Two and should be retained in future work. In addition, we recommend that paragraph 617 be clarified to include UPEs subject to tax neutrality regimes among the categories of entities the income of which is excluded from the scope of the GloBE rules and, by extension, the STTR.

Administration and Implementation

The Pillar Two Blueprint rules are extremely complex. They will be difficult and costly for MNEs to implement and for tax authorities to administer. Tax certainty and the elimination of double taxation requires all tax authorities to interpret and implement the Pillar Two rules in the same way.

The GLoBE proposal should be implemented at the same time by all members of the Inclusive Framework, for the same period, be prospective only and be consistently applied. How the Pillar One and Pillar Two proposals interact must be carefully considered and those interactions clarified. For example, will the reallocation under Pillar One occur before the application of Pillar Two? Clear rules on the interaction and the ordering of the two pillars should be addressed.

To avoid disputes and provide certainty, strong dispute resolution mechanisms are essential. The rules must include highly effective dispute resolution mechanisms and mandatory binding arbitration or similar binding mechanisms as minimum standards subject to peer review.

The NFTC believes that the Pillar One and Pillar Two proposals need to be continually evaluated by the OECD to assess the total impact of these proposals on both taxpayers and tax administrators.

The NFTC strongly believes that any non-compliant existing unilateral measures as well as any proposed or contemplated unilateral measures should be withdrawn as a condition of reaching consensus on both Pillar One and Pillar Two. This would include any unilateral measures, such as digital service taxes, equalization levies, diverted profit taxes, the U.K. offshore receipts tax and any similar extraterritorial tax, withholding tax that would be seen as double counting, and other similar measures including those developed after the release of the Pillar Two Blueprint. Consideration should be given to requiring a country-specific list of relevant unilateral measures that would need to be repealed as part of any agreement In the same way that BEPS Action 5 agreed to review all preferential regimes to determine if they were harmful, and to then continually update those reviews for new regimes, so too should the OECD review all unilateral measures and then continually update those reviews for new unilateral measures, with sanctions for countries that fail to repeal or introduce new unilateral measures.

Conclusion

The proposals in the Pillar Two Blueprint appear to reflect the concern that, notwithstanding the BEPS changes and U.S. tax reform, opportunities remain, at least for non-U.S. multinationals, to shift profits to low or no-tax jurisdictions or to convert profits to stateless income. The BEPS changes have resulted in considerable changes in behavior among multinational enterprises and governments. New tax legislation, including the EU's Anti-Tax Avoidance Directive (ATAD) and the U.S. Tax Cuts and Jobs Act (TCJA) have gone beyond the BEPS minimum standards. We therefore recommend the if the GLoBE and Subject to Tax proposals are considered, such consideration comes only after a review of the efficacy of the BEPS changes that have already been put into place, as required by Action 11, and careful consideration of the policy rationale for a universally agreed global minimum taxation regime, to determine whether further measures are needed.

Sincerely,

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Appendix to NFTC Comments on the Pillar Two Blueprint

NFTC Board Member Companies:

ABB Incorporated
Amazon
American International Group
Amgen
Anheuser-Busch
Applied Materials
BP America Inc.
British American Tobacco Company
Caterpillar Inc.
Chevron Corporation
Cisco Systems, Inc.
Coca Cola Company (The)
ConocoPhillips, Inc.
Corning Incorporated
Dentons US LLP
DHL Express (USA) Inc.
DLA Piper LLP (US)
eBay Inc.
EmPath
Ernst & Young LLP
ExxonMobil Corporation
Facebook
FCA US LLC
FedEx Express
Fluor Corporation
Ford Motor Company
General Electric Company
Google Inc.
Halliburton Company
Hanesbrands Inc.
Hewlett Packard Enterprise Company
IBM Corporation
Johnson Controls
KPMG LLP
Mars Incorporated
Mastercard International
McCormick & Company, Inc.
Microsoft Corporation
Mondelēz International, Inc.
National Foreign Trade Council
Oracle Corporation
Pernod Ricard USA
Pfizer International Incorporated
Pitney Bowes
PricewaterhouseCoopers LLP
Procter & Gamble Company
Qualcomm Incorporated
Samsung Electronics
Siemens Corporation
TE Connectivity
Texas Instruments
Total
Toyota Motor North America
Raytheon Technologies
UPS
Visa Inc.
Walmart